

An organization incorporated under state laws for the county-wide advancement and improvement of agriculture, which in addition to the activities in furtherance of its purposes purchases supplies and equipment for resale to members, is an organization exempt from tax under section 501(a) of the Internal Revenue Code of 1954 as an organization of the type described in section 501(c)(5) of the Code. It is, however, subject to tax under section 511 of the Code on the unrelated business income resulting from the resale of supplies and equipment.

Advice has been requested whether an organization incorporated under state laws for the advancement and improvement of agriculture which in addition to its educational and other activities in furtherance of its purposes engages in the purchase of supplies and equipment for resale to members, is exempt from tax as an organization described in section 501(c)(5) of the Internal Revenue Code of 1954.

The instant organization was incorporated generally to provide a county-wide medium for the advancement and improvement of agriculture. Its charter provides that it may market agricultural products for producers and purchase supplies and equipment for such producers. In addition to its usual educational and other activities in furtherance of agriculture, it is engaged in the purchase of supplies and equipment, the bulk of which is fertilizer, for resale to its members and others.

Section 501(a) of the Code provides an exemption from Federal income tax for labor, agricultural and horticultural organizations as described in section 501(c)(5) of the Code. Such organizations contemplated by law as exempt are those which (1) have no net income inuring to the benefit of any member; (2) are educational or instructive in character, and (3) have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of certain organizations, including agricultural organizations, which are otherwise exempt from tax under section 501(a) of the Code, which is derived from any unrelated trade or business regularly carried on by such organizations.

Section 39.422-3 of Regulations 118 states, in part, that the income of an exempt organization is subject to taxation on business income only if two conditions are present with respect to such income. The first condition is that the income must be from a trade or business regularly carried on by the organization. The second condition is that the trade or business must not be substantially related (aside from the need of the

organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its purpose or function constituting the basis for its exemption from tax. Regulations 118 are made applicable to the Internal Revenue Code of 1954, insofar as applicable, by Treasury Decision 6091, C.B. 1954-2, 47.

The regulations further state that a trade or business is regularly carried on when the activity is conducted with sufficient consistency to indicate a continuing purpose of the organization to derive some of its income from such activity. An activity may be regularly carried on even though its performance is infrequent or seasonal. Ordinarily, a trade or business is substantially related to the activities for which an organization is granted exemption if the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization is granted exemption. In the usual case, the nature and size of the trade or business must be compared with the nature and extent of the activities for which the organization is granted exemption in order to determine whether the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization was granted exemption.

The sale of supplies and equipment is a business of a kind ordinarily carried on for profit. Such activity cannot be said to be substantially related to the activities constituting the basis for exemption of the instant organization, other than through the accrual of earnings to help defray expenses.

Accordingly, it is held that an organization incorporated under state laws for the county-wide advancement and improvement of agriculture, which in addition to the usual activities in furtherance of its purposes purchases supplies and equipment for resale to members, is exempt from income tax under section 501(a) of the Code as an organization of the type described in section 501(c)(5) of the Code, but is subject to tax under section 511 of the Code on the unrelated business income resulting from the resale of supplies and equipment.